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IN THE

Supreme Court of the United States

OCTOBER TERM, 1929

No. 301

RAILROAD COMMISSION OF WISCONSIN, LEWIS E. GETTLE, ADOLPH KANNEBERG, ET AL., ETC.,

Appellants,

v.

W. G. MAXCY, as Receiver of the Washburn Water Works and Washburn Water Works Company.

Brief for Appellants

JOHN W. REYNOLDS,
Attorney General,

SUEL O. ARNOLD,
Special Counsel,

Attorneys for Appellants.

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No. 301

RAILROAD COMMISSION OF WISCONSIN, LEWIS E. GETTLE, ADOLPH KANNEBERG, ET AL., ETC.,

Appellants,

v.

W. G. MAXCY, as Receiver of the Washburn Water Works and Washburn Water Works Company.

Brief for Appellants

On April 5, 1929, a decree was handed down by the District Court of the United States for the Western District of Wisconsin, three judges sitting as a statutory court, perpetually enjoining the appellants, Lewis E. Gettle, Adolph Kanneberg, and A. R. McDonald, constituting the Railroad Commission of Wisconsin, and John W. Reynolds, as Attorney General of the State of Wisconsin, from taking any steps to enforce the order of the Railroad Commission

of Wisconsin dated December 4, 1928, and restraining the appellants from interfering with the Washburn Water Works Company or its receiver, W. G. Maxcy, in charging and collecting reasonable rates for water furnished in the city of Washburn, Wisconsin. No decision was filed by the lower court. The appellants have appealed to the Supreme Court of the United States under the provisions of sec. 238, Judicial Code, as amended by Act of February 13, 1925.

STATEMENT OF THE CASE

The Washburn Water Works Company was organized as a Wisconsin corporation in 1889 for the purpose of operating a water utility in the city of Washburn, Wisconsin (R. 103). Since the 19th day of May, 1925, the affairs of the corporation have been in charge of W. G. Maxcy, as receiver (R. 5). On December 12, 1927, the receiver attempted to file with the Railroad Commission of Wisconsin a schedule of rates in excess of the rates previously authorized by the Commission (R. 35, 55), but the Commission refused to file these schedules (R. 11, 70). Thereafter the receiver filed with the Railroad Commission of Wisconsin an application for an increase in rates (R. 11). The Railroad Commission proceeded to hold a hearing upon the application, evidence was introduced before the Commission, and on December 4, 1928, the Railroad Commission entered an order denying an increase in general service rates, but granting an increase in rates for fire protection service (R. 48-52).

Prior to December 4, 1928, the Railroad Commission of Wisconsin had made several valuations of the property of the Washburn Water Works Company. In the order entered in December, 1910, the Commission found the investment cost of the Washburn Water Works property be-

fore depreciation to be $69,348.00 and the depreciated value to be $63,803.00 (R. 9). A valuation was made by the Commission in October, 1921, in which the Commission added to the valuation made in 1910 the additions made subsequent to that date, and thereby obtained the figure of $80,792.00 which was used as a rate base by the Commission at that time (R. 10). The Railroad Commission made a valuation of the property as of June 30, 1923, in which the Commission found the value of the property based on cost of reproduction new to be $132,862.00, and the value based on a ten year average price basis to be $106,838.00, undepreciated, and a depreciated value to be $91,599.00 (R. 10). Some time later a proceeding was instituted by the city of Washburn to acquire the property of the Washburn Water Works Company, and as a part of this proceeding the Commission, under date of April 10, 1924, found the value of the Washburn Water Works property to be $50,000.00 (R. 29-41).

In the order of December 4, 1928, the Commission found a reproduction cost as of January 1, 1928, on a present price basis to be $114,089.00 and the depreciated value to be $87,116.00 (R. 48). The values thus found by the Commission did not include working capital, materials or supplies (R. 154). The Commission allowed $800.00 for materials and supplies, and $1,700.00 for working capital (R. 124). The Commission found the value of the property on a split inventory basis to be $71,530.00 (R. 39).

In the order of December 4, 1928, the Commission found that the fair value of the property of the Washburn Water Works Company for rate making purposes was $75,000.00 (R. 48). In arriving at this value the Commission called attention to the fact that property values in the city of Washburn had suffered a great decline, that there was no prospect of values increasing in the immediate fu-

ture, and that the value of the public utility property must be held to be affected by the decline in general property values in the city of Washburn (R. 48).

In establishing a rate to be charged by the Washburn Water Works Company, upon the value of $75,000.00, the Commission called attention to the fact that operating costs of the utility could be reduced by the installation of an electrical pump (R. 49-51). The Commission also pointed out that further saving in operating costs could be affected by the installation of meters (R. 51). The Commission therefore in estimating the operating expenses for the year 1929 refused to take into consideration actual past operating expenses and also refused to consider legal expenses incident to litigation between the Washburn Water Works Company and the Railroad Commission (R. 51). The order of the commission provides for a 7% return on the value of $75,000.00 (R. 52).

On the second day of January, 1929, the Washburn Water Works Company and W. G. Maxcy, as receiver, filed a bill of complaint in the District Court of the United States for the Western District of Wisconsin in which it is alleged that the value of $75,000.00 did not represent the fair value of the property, and that the rates prescribed in the order of the Commission dated December 4, 1928, were confiscatory (R. 14, 16). On January 3, 1929, the District Court of the United States for the Western District of Wisconsin issued a temporary restraining order, enjoining the appellants from interfering or attempting to interfere with the Washburn Water Works Company and its receiver W. G. Maxcy, charging and collecting rates set forth in Schedule D attached to the bill of complaint (R. 60-61). Schedule D purports to set up rates which provide a 6% return on a value of $110,000.00 (R. 53-55).

The case was tried before a statutory court, consisting of three judges (R. 102). Both the appellants and the appellees introduced evidence by way of affidavit, pursuant to stipulation (R. 102).

The utility introduced evidence showing that the value of the Washburn Water Works Company, based on cost of reproduction new was $138,537.00, and that the value depreciated was $117,952.00 (R. 114), excluding going value. The utility estimates going value at the sum of $5,000.00 (R. 110). The utility also introduced in evidence a statement of estimated operating expenses for the year 1929, including a return of 8% on a value of $122,952.00, which estimate amounted to $29,090.00 (R. 108). The Commission estimated the operating expenses for the year 1928, including a 7% return on the value of $75,000.00 to be $18,118.32 (R. 52).

After the introduction of the evidence, and after hearing arguments of counsel, the court entered a decree granting a perpetual injunction against the appellants, as prayed for by the utility, on the ground that the evidence before the Commission, and on the record herein, did not support the value of $75,000.00 established by the Railroad Commission in the order dated December 4, 1928 (R. 92-93).

SPECIFICATION OF ASSIGNED ERRORS

First. That the court erred in decreeing that the defendants, and each of them, be perpetually enjoined from taking any steps to enforce the order of the Railroad Commission, dated December 4, 1928, a copy of which is attached to the plaintiffs' bill of complaint as Exhibit C in this proceeding, and enjoining the said defendants and each of them from taking any steps whatsoever to require the plaintiffs to change the rates prescribed in the said order, or to carry out any directions contained in said order, and

enjoining the defendants and each of them from interfering with the plaintiffs in charging and collecting the rates set forth in the schedule of rates marked Exhibit D, attached to the plaintiffs' bill of complaint.

Second. That the court erred in holding that the valuation fixed by the defendant railroad commission of Wisconsin in its order dated the 4th day of December, 1928 assigning a value of $75,000.00 to the property of the plaintiffs for rate making purposes was not and is not supported on the record before the commission and on the record herein.

Third. That the court erred in failing to hold that the rates fixed by the said order of the defendant railroad commission dated December 4, 1928 were and are adequate and reasonable and yield a fair and adequate return on the value of the plaintiffs' property used and useful in connection with the plaintiffs' business as a public water utility at Washburn, Wisconsin.

SUMMARY OF ARGUMENT

I. Cost of reproduction new, less depreciation, is not the sole or dominant element of valuation, but all elements entering into the particular case should be considered.

II. Evidence of economic conditions in the community where a utility is located may be considered in fixing the value of the public utility property.

III. Order of the Commission fixing value of $75,000.00 is supported by the evidence.

1. *Value of $89,616.00, based on cost of reproduction new, is not unreasonable.*

   A. Going value.

2. *Commission accorded proper weight to cost of reproduction new.*

   A. Property values in the city of Washburn are low.
   B. Shrinkage of population.
   C. Scarcity of industries in the city.
   D. Plant as constructed is larger than required.
   E. Evidence as to conditions in the city of Washburn undisputed.

3. *Rights of the public should be considered.*

IV. Rates fixed by order of the Commission not confiscatory.

1. *Order makes proper provision for operating expenses.*

   A. Pumping costs for the year 1928 excessive.
   B. Installation of meters would result in decreased operating cost.
   C. Legal expenses should not be considered as normal operating expenses.

2. *Past losses need not be considered in fixing rates.*

3. *Return of 7% on a value of $75,000.00 not confiscatory.*

ARGUMENT

I. Cost of reproduction new, less depreciation, is not the sole or dominant element of valuation, but all elements entering into the particular case should be considered.

The decree recites that the valuation fixed by the ap-

pellant Railroad Commission of Wisconsin in its order dated December 4, 1928 assigning a value of $75,000.00 to the property of the Washburn Water Works Company for rate making purposes was not and is not supported on the record before the Commission and on the record herein (R. 92). This recital in the decree must be read in the light of the finding by the Railroad Commission that the reproduction cost of the Washburn Water Works property as of January 1, 1928, on a present price basis (excluding materials and supplies and working capital) was $114,089.00 and the value depreciated was $87,116.00 (R. 19). The Commission fixed a value of $75,000.00 for the reason, as is stated in the order, that other classes of property in the city of Washburn had suffered a great decline in value; that there is no prospect that such decline is temporary or that substantial values will be re-established; and that to hold that the water works property had not been affected by this decline would be to ignore the facts (R. 48). It is thus apparent from the face of the order of the Commission that while cost of reproduction new was considered by the Commission, it was not accorded great weight solely because property values generally in the city of Washburn had suffered a great decline. The question therefore is squarely presented as to the weight which must be accorded to cost of reproduction new.

The decisions of this court holding that cost of reproduction new must be considered in a public utility valuation case are numerous. We do not, however, find any case in which the principle is established that cost of reproduction new must be accorded dominant weight regardless of other facts and circumstances in the particular case.

In *Smyth v. Ames*, 169 U. S. 466, the United States Supreme Court in enunciating the cost of reproduction principle said, pages 546-547:

"We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. *We do not say that there may not be other matters to be regarded in estimating the value of the property.* What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth. * * *." (Italics ours.)

In *Knoxville v. Knoxville Water Company*, 212 U. S. 1, the court said, at page 9:

"* * * The cost of reproduction is one way of ascertaining the present value of a plant like that of a water company, but that test would lead to obviously incorrect results, if the cost of reproduction is not diminished by the depreciation which has come from age and use. * * *."

In this case the court recognizes that while cost of reproduction new is a factor to be considered, depreciation must also be considered.

In *Willcox v. Consolidated Gas. Co.*, 212 U. S. 19, the court said at page 52:

"And we concur with the court below in holding

that the value of the property is to be determined as of the time when the inquiry is made regarding the rates. If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase. This is, at any rate, the general rule. We do not say there may not possibly be an exception to it, where the property may have increased so enormously in value as to render a rate permitting a reasonable return upon such increased value unjust to the public. How such facts should be treated is not a question now before us, as this case does not present it. We refer to the matter only for the purpose of stating that the decision herein does not prevent an inquiry into the question when, if ever, it should be necessarily presented."

In *Minnesota Rate Cases,* 230 U. S. 352, the court said, at page 434:

"The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment, having its basis in a proper consideration of all relevant facts. * * *."

The court further said, on page 452:

"* * * The cost-of-reproduction method is of service in ascertaining the present value of the plant, when it is reasonably applied and when the cost of reproducing the property may be ascertained with a proper degree of certainty. * * *."

In *Missouri ex rel. S. W. Bell T. Co. v. Public Serv. Comm.,* 262 U. S. 276, the court said at page 287:

"It is impossible to ascertain what will amount to a fair return upon properties devoted to public service without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made. * * *."

In *Georgia Railway & Power Co. v. Railroad Comm.*, 262 U. S. 625, the court said, page 630:

> "The refusal of the commission and of the lower court to hold that, for rate-making purposes, the physical properties of a utility must be valued at the replacement cost, less depreciation, was clearly correct. * * *."

Citing *Minnesota Rate Cases*, 230 U. S. 352, 434; *Smyth v. Ames*, 169 U. S. 466, 546, 547; *Willcox v. Consolidated Gas Co.*, 212 U. S. 19.

In *Bluefield Water Works and Improvement Company v. Public Service Comm.*, 262 U. S. 679, the court held that reproduction cost at present prices cannot be ignored in fixing rates for a public utility established before the war.

In *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 410-411, the court said:

> "It is well established that values of utility properties fluctuate, and that owners must bear the decline and are entitled to the increase. The decision of this court in Smyth v. Ames, 169 U. S. 466, 547, 42 L. ed. 819, 849, 18 Sup. Ct. Rep. 418, declares that to ascertain values 'the present as compared with the original cost of construction' is, among other things, matters for consideration. But this does not mean that the original cost or the present cost or some figure arbitrarily chosen between these two is to be taken as the measure. The weight to be given to such cost figures and other items or classes of evidence is to be determined in the light of the facts of the case in hand. By far the greater part of the company's land and plant was acquired and constructed long before the war. The present value of the land is much greater than its cost; and the present cost of construction of those parts of the plant is much more than their reasonable original cost. In fact, prices and values have so changed that the amount paid for land in the early years of the enter-

prise and the cost of plant elements constructed prior to the great rise of prices due to the war do not constitute any real indication of their value at the present time. Standard Oil Co. v. Southern P. Co. 268 U. S. 146, 157, 69 L. ed. 890, 895, 45 Sup. Ct. Rep. 465; Georgia R. & Power Co. v. Railroad Commission, 262 U. S. 625, 630, 631, 67 L. ed. 1144, 1147, 1148, 43 Sup. Ct. Rep. 680; Bluefield Waterworks & Improv. Co. v. Public Serv. Commission, 262 U. S. 691, 692, 67 L. ed. 1182, 1183, 43 Sup. Ct. Rep. 675; Missouri ex rel. Southwestern Bell Teleph. Co. v. Public Serv. Commission, supra, 287 (67 L. ed. 984, 31 A.L.R. 807, 43 Sup. Ct. Rep. 544). Undoubtedly, the reasonable cost of a system of waterworks, well planned and efficient for the public service, is good evidence of its value at the time of construction. And such actual cost will continue fairly well to measure the amount to be attributed to the physical elements of the property so long as no change in the level of applicable prices. And, as indicated by the report of the commission, it is true that, if the tendency or trend of prices is not definitely upward or downward and it does not appear probable that there will be a substantial change of prices, then the present value of lands plus the present cost of constructing the plant, less depreciation, if any, is a fair measure of the value of the physical elements of the property. * * *."

In *St. Louis & O'Fallon R. Co. v. United States*, 73 L. ed. 798, 49 Sup. Ct. Rep. 384, 279 U. S. 461, the court said, at pages 484-485:

"'The elements of value recognized by the law of the land for rate-making purposes' have been pointed out many times by this Court. Smyth v. Ames, 169 U. S. 466, 42 L. ed. 819, 18 Sup. Ct. Rep. 418; Willcox v. Consolidated Gas Co. 212 U. S. 19, 53 L. ed. 382, 48 L.R.A. (N. S.) 1134, 29 Sup. Ct. Rep. 192, 15 Ann. Cas. 1034; Minnesota Rate Cases (Simpson v. Shepard) 230 U. S. 352, 57 L. ed. 1511, 48 L.R.A. (N. S.)

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"Thirty years ago, Smyth v. Ames, supra, announced (169 U. S. 546, 42 L. ed. 849, 18 Sup. Ct. Rep. 418):

" 'We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth.'

"In Missouri ex rel. Southwestern Bell Teleph. Co. v. Public Serv. Commission, supra (262 U. S. 287, 67 L. ed. 984, 31 A.L.R. 807, 43 Sup. Ct. Rep. 544), we said: 'It is impossible to ascertain what will amount to a fair return upon properties devoted to public service without giving consideration to the cost of

labor, supplies, etc., at the time the investigation is made. An honest and intelligent forecast of probable future values made upon a view of all the relevant circumstances is essential. If the highly important element of present costs is wholly disregarded such a forecast becomes impossible. Estimates for to-morrow cannot ignore price of to-day.' "

Other cases involving value of public utility properties decided during the period covered by the foregoing decisions are:

Denver v. Denver Union Water Co., 246 U. S. 178, 191;
Newton v. Consolidated Gas Co., 258 U. S. 165, 176;
Galveston Electric Co. v. Galveston, 258 U. S. 388;
Lincoln Gas & Electric L. Co. v. Lincoln, 250 U. S. 256.

It will be noted from the foregoing decisions that the United States Supreme Court, while holding that cost of reproduction new must be accorded weight in a valuation proceeding, has never held that cost of reproduction new is the sole element to be considered in a valuation case, or that cost of reproduction new must, in every case, be given dominant weight. It is particularly significant to note that the decision in *Smyth v. Ames, supra,* is still the law of the land, as was expressly held in the *O'Fallon* case. It follows therefore that while cost of reproduction new must be given consideration, as was said in *Smyth v. Ames, supra,* there may be other matters to be considered in fixing the value of public utility property.

It is, of course, fundamental that a public utility is entitled to receive a fair return upon the fair value of its property at the time it is being used for the public. *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, 41. The problem presented in each case is that of determining the fair value of the property considering all the facts and circumstances

surrounding such property. We must never lose sight of the fact that value is the thing to be found, and that the ascertainment of value is not controlled by artificial rules. As the court in *Standard Oil Co. v. Southern Pacific Co.*, 268 U. S. 146, 156, said:

> "It is to be borne in mind that value is the thing to be found, and that neither cost of reproduction new, nor that less depreciation, is the measure or sole guide. The ascertainment of value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts. * * *."

In speaking of the ascertainment of value in a utility rate case, the Special Master in *Brooklyn Borough Gas Co. v. Prendergast*, 16 F. (2d) 615, said, page 624:

> "There is not the same clarity or uniformity of expression as to how the present value is to be ascertained. No fixed formula has been prescribed by the Supreme Court. Indeed, that court has expressly ruled that it is not a matter of formula or of fixed rules. That court has never gone so far as to say that reproduction cost new is the only element to be considered. Nor, on the other hand, has it ever selected any particular method as the one and only decisive means of calculating value."

In the case at bar the Railroad Commission carefully considered cost of reproduction new, but arrived at the conclusion that, in view of the unusual conditions prevailing in the city of Washburn, cost of reproduction new did not reflect the true value of the utility property. The Commission was not compelled to give dominant weight to cost of reproduction new, as is shown by the decision in *Georgia Ry. & Power Co. v. Railroad Comm.*, 262 U. S. 625, where the court said, pages 629-630:

"Here the Commission gave careful consideration to the cost of reproduction, but it refused to adopt reproduction cost as the measure of value. It declared that the exercise of a reasonable judgment as to the present 'fair value' required some consideration of reproduction costs as well as of original costs, but that 'present fair value' is not synonymous with 'present replacement cost,' particularly under abnormal conditions. That part of the rule which declares the utility entitled to the benefit of increases in the value of property was, however, specifically applied in the allowance of $125,000, made by the Commission to represent the appreciation in the value of the land owned. The lower court recognized that it must exercise an independent judgment in passing upon the evidence; and it gave careful consideration to replacement cost. But it likewise held that, there was no rule which required that in valuing the physical property, there must be 'slavish adherence to cost of reproduction, less depreciation.' It discussed the fact that, since 1914, large sums had been expended annually on the plant; that part of this additional construction had been done at prices higher than those which prevailed at the time of the rate hearing; and it concluded that, 'averaging results and remembering that values are . . . matters of opinion, . . . no constitutional wrong clearly appears.'"

II. Evidence of economic conditions in the community where a utility is located may be considered in fixing the value of the public utility property.

We premise our argument that economic conditions in the community where a public utility is located is relevant upon the proposition that all elements which in any way affect value may properly be considered in fixing the value of public utility property. Undoubtedly, in the typical case where the community is experiencing a healthy and steady growth, cost of reproduction new less deprecia-

tion should be given major consideration. It is our position, however, that in a city like Washburn, where the population is steadily diminishing, where property values are declining, where tax delinquencies are relatively enormous, cost of reproduction new does not and cannot reflect true value of the utility property located therein.

The lower court proceeded upon the theory that evidence of economic conditions was relevant in a rate proceeding. It overruled the motion made by the utility to strike out Paragraph XXIV of the answer in which it is alleged that the city of Washburn is in a decadent condition; that real estate values have declined to a mere fraction of former values; that the tax delinquencies in the city are enormous; that the value of the Washburn Water Works property has been affected by this condition (R. 10, 86). Furthermore, the lower court allowed the appellants to introduce evidence sustaining the allegations contained in Paragraph XXIV of the answer, over the objections of the utility (R. 120-121, 139, 144-145, 146-147, 148-149, 150, 151-152).

These rulings of the lower court were clearly correct. The cost-of-reproduction principle is based upon the proposition that "If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of that increase."

> *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, 41; *Bluefield W. W. & Imp. Co. v. Public Service Commission*, 262 U. S. 679, 690.

> "It is well established that values of utility properties fluctuate, and that owners must bear the decline and are entitled to the increase."

> *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 410.

Upon the cost of reproduction principle there has been engrafted a limitation to the effect that the utility cannot claim an increase in value beyond property values generally in the community where the utility is located. In *Minnesota Rate Cases*, 230 U. S. 352, 454, the court said:

> "And where the inquiry is as to the fair value of the property, in order to determine the reasonableness of the return allowed by the rate-making power, it is not admissible to attribute to the property owned by the carriers a speculative increment of value, over the amount invested and beyond the value of similar property owned by others, solely by reason of the fact that it is used in public service. That would be to disregard essential conditions of the public use, and to make the public use destructive of the public right."

In *Middlesex Water Co. v. Board of Public Utility Commrs.*, 10 F. (2d) 519, the special master whose report was affirmed by the court said, page 522:

> "Also, it is the duty of a legislative body, the defendant board, and this court (Minnesota Rate Cases, 230 U. S. 352, 455) to recognize that a utility company is entitled to a reasonable measure in the general prosperity of the communities which it serves, still it is said the increase so allowed cannot properly extend beyond the normal market value of land in the vicinity having a similar character."

As we shall hereafter show, property values in the city of Washburn have declined to a fraction of their former value. This condition is the result of a process of decay obtaining in the city, the population of which has been steadily declining for a number of years. Other property in the city does not have a value commensurate with cost of reproduction new. It must inevitably follow, as the Railroad Commission pointed out in its order (R. 48-49),

that the value of the Washburn Water Works utility property has been adversely affected by the decline of general property values in the city. The utility clearly is not entitled to value of its property in excess of values of other similar property in the city. It follows, therefore, that evidence of property value generally in the city of Washburn is entitled to great weight in the case at bar.

We have, in this case, direct evidence to the effect that the value of the Washburn Water Works property has been adversely affected by the retrogressive condition of the city of Washburn. We refer to the fact that the Washburn Water Works Company is, at the present time, operating under a receiver. There is no claim made by any of the parties to this suit that the utility has been, in the past, negligently or extravagantly operated (except in regard to the installation of meters and the installation of a smaller electrical pump, which will be commented upon later). Why then is the company in the hands of a receiver? Counsel will attempt to answer this question by saying that the receivership resulted through the failure of the Railroad Commission to fix adequate rates. The fact remains, however, that, between 1910 and 1921, the utility did not make application to the Commission for an increase in rates (R. 139). Furthermore, the rates heretofore charged by the Washburn Water Works Company are among the highest in the state of Wisconsin (R. 39). It it obvious that the receivership resulted because of the decay of the city.

The weight to be given to the various elements which affect value "is to be determined in the light of the facts of the case in hand." *McCardle v. Indianapolis Water Co.*, 272 U. S. 400. In the cases formerly before the supreme court, land values had increased tremendously. In *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 410-411, it appeared that

> "By far the greater part of the company's land and plant was acquired and constructed long before the war. The present value of the land is much greater than its cost; and the present cost of construction of those parts of the plant is much more than their reasonable original cost. In fact, prices and values have so changed that the amount paid for land in the early years of the enterprise and the cost of the plant elements constructed prior to the great rise of prices due to the war do not constitute any real indication of their value at the present time."

Washburn, in common with the majority of communities in the United States, experienced a boom period during the war. Property values in the city during this period increased from two hundred fifty to one thousand percent (R. 116). Unlike many cities, however, values after the war suffered a great decline (R. 116-117). In these circumstances, it is clear that the value of the utility property was much greater during the war period, than it is at the present time. To illustrate the decline in values, we call the court's attention to the fact that in the year 1890 the utility purchased some real estate, paying therefor the sum of $1,000.00 (R .147). The utility has other real estate, used and useful in its public utility business. Yet the total value of the real estate of the utility, as of February 1, 1929, according to the figures of Mr. Hartt, the engineer employed by the utility to make a valuation of the utility property, is $275 (R. 114). It thus appears that the condition as to land values obtaining in the city of Washburn is exactly the reverse of that obtaining in the *McCardle* case, 272 U. S. 400.

The situation in regard to property values in the city of Washburn is clearly shown in the affidavit of W. G. Maxcy, the receiver of the Washburn Water Works Company. According to his affidavit, property values in the

city of Washburn in 1928 were practically the same as they were in 1914 and 1915 (R. 152). To say that the utility property should be valued upon the basis of 1928 prices in a community where 1914 values prevailed is to exalt the letter of the valuation principle above its spirit. If evidence as to property values generally has no bearing in a rate case, there cannot be any real inquiry as to the true value of utility property. We do not believe that this court will ever hold that the value of utility property must be computed strictly according to rigid formulas without any regard to actual value.

Our position may best be illustrated by a hypothetical situation. Suppose during the recent oil boom in Michigan, a city of 5,000 inhabitants springs up over night. A water utility is brought into being, and constructs a plant sufficient in size to accommodate all the inhabitants. At the end of a year, the boom collapses, and the population is reduced to 500 people. In such case, can it be said that after the boom the utility property has a value approximating cost of reproduction new? Shall the 500 inhabitants be required to pay rates sufficient to produce a reasonable rate of return on a value based on cost of reproduction new? We have no doubt this court would answer these questions in the negative. The same condition exists in Washburn. The present plant was large enough to accommodate the increased population during the war; it was large enough to accommodate a population of 3,707 in 1920. Yet the utility now contends that it is entitled to the same return for serving a population of 2700 as it was when it served a population of 3700.

III. Order of the Commission fixing value of $75,000.00 is supported by the evidence.

The question as to whether the order of the Commis-

sion fixing a value of $75,000 for rate-making purposes is supported by the evidence necessarily involves the further question as to whether the Commission accorded proper weight to cost of reproduction new, less depreciation. The Commission, in its order, found that the value of the utility property based upon cost of reproduction new was $114,089, depreciated $87,116 (R. 48). The depreciated value does not include working capital materials and supplies. With these elements added, the depreciated value, as found by the Commission, is $89,616 (R. 154). At the trial, appellants introduced evidence showing a value based on cost of reproduction new, as of January 1, 1929, of $121,617, depreciated $93,364 (R. 124), exclusive of working capital, materials and supplies. The depreciated value, including these items, is $95,864 (R. 122, 124). The utility contends that the value of the utility property, as of February 1, 1929, based on cost of reproduction new was $138,537, depreciated $117,952 (R. 114). In view of the wide spread between the values computed by the utility and the commission, we shall first direct our attention to the question of value based on cost of reproduction new. The solution of this question is of utmost importance in the case at bar. If it appears, as we contend, that the depreciated value of $89,616 correctly reflects value based on cost of reproduction new, the difference between the value of $75,000 fixed by the order, and the value of $89,616 based on cost of reproduction new, amounts to $14,616. The appellants contend that the evidence supports the reduced value of $75,000; that such value comports with the value of similar property located in the city of Washburn.

1. *Value of* $89,616 *based on cost of reproduction new is not unreasonable.*

The difference between the values based upon cost of

reproduction new as determined by the utility and the commission relates primarily to a difference in prices of the various items included in a water plant, and a dispute over the depreciation. The inventory used by the utility and the commission is practically identical (R. 109).

To substantiate the prices used by the commission, the appellants introduced a graph and supporting data showing prices of cast iron pipe, extending over a period of several years (R. 128-138). Reference to the graph will disclose that the Railroad Commission used proper prices for six inch cast iron pipe, one of the major items of a water plant.

Pursuant to stipulation (R. 102) the issues in the case were tried on affidavits. There was, therefore, no cross-examination of Mr. Hartt, the utility's engineer, nor of Mr. Thiessen, the commission's engineer, as to the method adopted by them in arriving at unit prices used in their respective valuations.

The difference between the valuation of $89,616, and the valuation of $95,864, as of January 1, 1929 (both valuations having been made by the commission) is due almost entirely to an increase in the price of cast iron pipe. Mr. Thiessen, who made the valuation for the commission, testified in his affidavit that on January 1, 1928, the price for six inch cast iron pipe at the trench ready to lay was $40.40 per ton, while on January 1, 1929, the price had advanced to $49.35 per ton (R. 123).

The difference between the values as fixed by the Commission and as computed by the utility is caused in part by the item of depreciation. Mr. Thiessen, the commission's engineer, expressly states in his affidavit that he arrived at the per cent condition of cast iron pipe "upon the basis of probable deteriorati and reduced carrying capacity, resting upon samples, tests, observation and gen-

eral experience of pipes under conditions in the Lake Superior District as well as elsewhere in Wisconsin. The arbitrary method known as the four per cent sinking fund method of determining the per cent condition has not been used. The per cent condition ascribed to each item of the inventory is intended to reflect true present physical condition to the best of our knowledge and belief" (R. 122).

Mr. Hartt, the engineer employed by the utility, testified in regard to depreciation as follows (R. 110):

> "From personal knowledge of this affiant with the practice of utility companies generally, this affiant is of the opinion that the four per cent sinking fund method is a proper method of reflecting the actual results of depreciation of property for the reason that the fund established for such purposes is in practice invariably invested in the property of such company or in securities netting the company a sum equal to or in excess of four per cent and therefore by the use of such four per cent sinking fund method the result obtained reflects the actual practice in the business and the accepted method of supplying the depreciation fund, while the straight line method presupposes that no investment of such fund is made, which is contrary to the practice."

Mr. Hartt also states in his affidavit (R. 110) that in arriving at the depreciated value of the utility property, he took into consideration his knowledge of the general effect of Lake Superior water upon the mains, that such water does not scale the pipes, as disclosed by inspection of mains at Superior and Ashland that have been in use over thirty years without showing any visible sign of deterioration on the inside of the pipe, and that he also inspected various other elements of the plant, and some of the mains that had been cut.

While Mr. Hartt testifies that he figured depreciation

by inspecting the property, it is nevertheless apparent that he considers the four per cent sinking fund method the proper method of figuring depreciation. Mr. Hartt's views concerning the four per cent sinking fund method of computing depreciation do not coincide with the decisions of this court. In determining depreciation "The testimony of competent valuation engineers who examined the property and made estimates in respect of its condition is to be preferred to mere calculations based on averages and assumed probabilities." *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 416; *Pacific Gas & E. Co. v. San Francisco*, 265 U. S. 403, 406; *Standard Oil Co. v. Southern Pacific Co.*, 268 U. S. 146, 159. To the extent that depreciation is figured by Mr. Hartt on a sinking fund basis, it must be rejected.

We suggest to the court that the differences between the valuations made by the Commission, and the valuation made by the utility may be ascribed to a desire on the part of the utility to establish for rate-making purposes the highest possible value which may be given to the property, on a cost of reproduction basis. The court has never held that a value fixed by an administrative board or tribunal must be the highest value which can possibly be arrived at. In *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, the court held that under the evidence in the case the value of the utility property was not less than $19,000,000, notwithstanding that there were three valuations made on the basis of spot prices ranging from $19,500,000 to $22,669,000 (p. 418). The value thus held by the court to be the minimum for rate making purposes was $500,000 less than the lowest figure computed on the basis of cost of reproduction new.

The difference between the values contended for the utility, and those contended for by the commission is attributable to some extent to the fact that spot prices vary. For example, the graph introduced by the appellants showing prices of cast iron pipe (R. 128), indicates that the

value of a utility, and particularly a water utility, depends upon the particular date of the value inquiry. The graph shows that the prices of cast iron pipe had declined greatly on January 1, 1928, and that subsequently the prices made a partial recovery. We do not believe that the order of the commission fixing a value of $89,616 is unreasonable, when fluctuations in prices are considered.

It must not be forgotten that an order of the commission is presumed to be reasonable. In *Minnesota Rate Cases,* 230 U. S. 352, the court said, pages 452-453:

> "It is fundamental that the judicial power to declare legislative action invalid upon constitutional grounds is to be exercised only in clear cases. The constitutional invalidity must be manifest, and if it rests upon disputed questions of fact, the invalidating facts must be proved. And this is true of asserted value as of other facts."

Under the evidence in the case at bar we submit that the fair value of the utility property for rate-making purposes does not exceed the sum of $89,616.00.

The appellants introduced in evidence the valuation made by the Commission as of January 1, 1929, for the purpose of showing that prices of the items entering into a utility have not as yet become stable. The mere fact that prices on January 1, 1929 were higher than they were at the time of the investigation by the Commission does not indicate that the order fixing a value of $87,616.00, exclusive of materials and supplies and working capital, is unreasonably low. The graph introduced by the appellants (R. 128) shows that the prices of cast-iron pipe fluctuate greatly from month to month. The prices of other materials entering into a water plant likewise fluctuate. The Commission is entitled to exercise a reasonable amount of discretion in estimating prices for the future

and, in the absence of a clear abuse of discretion, the determination of the Commission ought to be final.

A. Going value.

In fixing the value of $89.616.00 based on cost of reproduction new, the Railroad Commission did not make any allowance for going value (R. 49, 154), nor do we believe that any allowance should be made for going value.

The United States Supreme Court has laid down the following rule with respect to going value:

> "That there is an element of value in an assembled plant doing business and earning money over one not thus advanced, is self-evident. This element of value is a property right, and should be considered in determining the value of the property upon which the owner has a right to make a fair return when the same is privately owned, although dedicated to public use."
>
> *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 416;
>
> *Denver v. Denver Union Water Co.*, 246 U. S. 178, 191, 192;
>
> *Des Moines Gas Co. v. Des Moines*, 238 U. S. 153, 165.

In the *McCardle* case, *supra*, the court cited the language used by the Railroad Commission as follows, page 414:

> "Any reasonable man with a knowledge of this property and the local conditions would unhesitatingly affirm that it had a value far in excess of the value of the pipe, buildings, grounds and machinery. Consider its earning power with low rates, the business it has attached, its fine public relations, its credit, the nature of the city and the certainty of large future growth, the way the property is planned and is being extended with the future needs of the city in view, its

operating efficiency and standard of maintenance, its desirability as compared with similar properties in other cities and with other utilities of comparable size in this city. These things make up an element of value that is actual and not speculative. It would be considered by a buyer or seller of the property or by a buyer or seller of its securities."

In *People ex rel. Kings County Lighting Co. v. Willcox,* 210 N. Y. 479, 104 N. E. 911, 912-913, the court said:

> "The company starts out with the 'bare bones' of the plant, to borrow Mr. Justice Lurton's phrase in the *Omaha Water Works Case* (218 U. S. 180, 30 S. Ct. 615, 54 Law Ed. 991, 48 L.R.A. (N. S.) 1084), *supra.* By the expenditure of time, labor and money, it coordinates those bones into an efficient working organism and acquires a paying business. The proper and reasonable cost of doing that, whether included in operating expenses or not, is as much a part of the investment of the company as the cost of the physical property. * * *."

In *New York Telephone Co. v. Prendergast,* 300 Fed. 822, 826, the court said:

> "It is found that this plaintiff was created, and does function, and functions very well; therefore, it has going value, because it goes well. The amount may be difficult of ascertainment, but that going value exists is self-evident."

It will be noted that the basis of the principle providing an allowance for going value is that the business is in fact a going business making money. In the *McCardle* case, *supra,* as well as in the other decisions cited, this fact clearly appears. It is clear from the evidence in this case that the Washburn Water Works Company is not in

fact a going concern as that term has been used in cases holding that allowance must be made for going value.

In *New York & Richmond Gas Co. v. Prendergast*, 10 F. (2d) 167, 177, the Special Master, in speaking of going value, said, pages 177-178:

> "Going value may, in my opinion, be defined as the difference between what a prospective purchaser would pay for a fully completed and equipped plant ready to operate, but which in fact had never operated, and one fully completed and equipped which was actually operating, with an established business, as a going concern. * * *."

The special master further said, page 179:

> "I am impressed, however, with the fact that there is not, and cannot be, any mathematical formula or method for computing the amount and present worth of going value. In the absence of demonstration through an actual purchase and sale transaction, under fair conditions, its ascertainment must be a matter of competent business judgment as to what a purchaser would be willing to pay for such elements and properties, rather than undergo the costs of acquiring them anew. * * *."

If we assume that going value is that sum which a buyer would consider in acquiring utility property, we submit that there is no element of going value attached to the property of the Washburn Water Works Company. It is neither a going concern nor a money-making concern as that term is used in the decisions. The rates in Washburn, without the increase applied for by the utility, are among the highest in the state of Wisconsin, and yet the utility concedes that it cannot be operated profitably. In fact, the company's record of water consumers, considered in conjunction with the shrinkage of population in the city, dem-

onstrates conclusively that the business of the utility has been diminishing and will continue to diminish in the future. Considering all the facts and circumstances surrounding the utility property in Washburn, the conclusion is irresistible that a prospective purchaser of a utility property would make no allowance for going value.

2. *Commission accorded proper weight to cost of reproduction new.*

In the preceding section of this brief we have called the court's attention to the fact that the Railroad Commission fixed a value of $75,000 for the utility property of the Washburn Water Works Company, notwithstanding the finding of a value of $89,616 based on cost of reproduction new. It is our contention that the evidence in the record was sufficient to justify the Commission in finding a value of $75,000.

A. Property values in the city of Washburn are very low.

It must be borne in mind that the city of Washburn was formerly a "sawmill town" (R. 116-117). Mr. Peavy, who in the past was mayor of the city, testified in a hearing held before the commission in 1923 that he had lived in the city of Washburn since the spring of 1910; that when he first came to the city the industries were equally divided between lumbering and the production of powder by the DuPont Company, at its plant located in the town of Barksdale, four miles southeast of the city (R. 116). He testified that there are now no sawmills in the city, but that there was a box factory which employed between 70 and 80 people (R. 117).

Mr. Robinson, who is a publisher, and who has resided in the city of Washburn for thirty-five years, testified in his affidavit that at the present time there are no industries in the city of Washburn except an excelsior factory which employs about twenty-five people, and a coal dock which employs on the average about fifteen men (R. 148). He further testified that the DuPont powder plant employed about three hundred men, two hundred of whom are residents of the city of Washburn (R. 148-149).

In view of the industrial condition of the city, it is natural to suppose that property values would be very low. Such is the situation which actually obtains. Mr. Peavy testified that prices of property increased during the war; that in 1920 prices began to drop; that in 1920 and 1921 the city was visited by numerous disastrous fires; that in 1921 and 1922 there were numerous mortgage foreclosures; that during the past twelve months (that is, prior to 1923) he did not know of a single bona fide sale of property in the city; that at mortgage foreclosure sales the only party bidding was the mortgagee; that in his opinion property values in the city were reduced to practically nothing (R. 116-117). He further testified that property values were lower than the assessed value (R. 116-117), and that in his judgment not five per cent of the property in Washburn could be sold for cash on the basis of assessed value (R. 117).

The situation with respect to property values generally is not confined to any particular part of the city. Bayfield street is the chief and only improved business street in the city, and is the only paved street in Washburn (R. 146). It is logical to suppose that the property abutting on this street would be the most valuable in the city, and yet the evidence discloses a tremendous number of vacant lots along the street (R. 146). The only explanation of these

vacancies is that the property has no value. Since property on the principal thoroughfare has but slight value, we must conclude that the remainder of the property in the city has a correspondingly low value.

A positive indication of decline in values may be found in the tax situation in the city. The map introduced by the appellants, in connection with the affidavits marked Exhibits CC and DD (R. 150-151) shows that taxes are delinquent on a very large part of the property in Washburn. The map shows in red property acquired by Bayfield county through tax deeds (R. 150), and shows in green the property upon which the taxes are delinquent for one or more years (R. 151). This map has not been printed, but was sent up to this court for inspection (R. 157-158). No argument is necessary in order to demonstrate that property upon which taxes are delinquent has no substantial value.

Probably no clearer illustration of the decline in value is afforded than that disclosed by a comparison of the value of a portion of the real estate now owned by the utility at the time it was purchased in 1890, and the present value of all the real estate owned by the utility. In 1890 a parcel of real estate was purchased by the utility for $1000.00 (R. 147). The utility now owns this parcel, together with additional land, and yet the value placed on all of the land now owned by the utility by Mr. Hartt, the engineer employed by the utility to make a valuation, is $275.00 (R. 114). The decline in value of the land owned by the utility is typical of the decline of land values generally throughout the city.

A further illustration of decline in value is found in the affidavit of W. G. Maxcy, the receiver of the Washburn Water Works Company, which was introduced by counsel representing the utility (R. 152-153). This affidavit shows that the true value of all the property in the city of Wash-

burn in 1914 was $1,241,223, and in the year 1928 amounted to $1,342,480 an increase of approximately $100,000 in this period. The affidavits further shows that the 1915 true value was $1,295,776, and the 1916 true value $1,518,638. The 1928 value exceeds the 1915 value by approximately $47,000 while the 1916 value is in excess of the 1928 value by approximately $175,000. It thus conclusively appears that property values in the city are substantially the same as they were in 1914 and 1915.

The greater portion of the utility property was constructed prior to the increase of prices during the war (R. 10). If Washburn were a normal community the utility would be entitled to a value reflecting 1928 prices. Property values generally, however, are practically identical with 1914 and 1915 values. In these circumstances, can it be said that the utility is entitled to have a value placed upon its property, based on cost of reproduction new? If this question must be answered in the affirmative, it must inevitably follow that in a rate proceeding actual value is immaterial, and that a figure representing cost of reproduction new must be taken as the measure of value. If such be the rule, *Smyth v. Ames*, 169 U. S. 466, is no longer the law.

We call the court's attention to the fact that the $75,000 value fixed by the Commission is in excess of values computed on the basis of 1914 and 1915 prices. The Commission found a split inventory value of $71,530.00 for the utility property (R. 49). It is apparent that the Commission in establishing a value of $75,000 has ascribed a value to the utility property in excess of values of similar property in the city.

B. Shrinkage of population.

A factor vitally affecting the value of the Washburn Water Works property is shrinkage of population in the

city. The population of the city of Washburn for the years 1905, 1910, and 1920, as disclosed by the affidavit of Thiessen, introduced by the appellants, was as follows (R. 139):

1905	4,924
1910	3,830
1920	3,707

Rev. Borucki, a Catholic priest in charge of the only Catholic congregation in the city of Washburn, testified in the affidavit introduced by the appellants that he has had charge of the Washburn congregation continuously since 1919; that according to the records of the church there were 1,265 members in the year 1917; that since 1919 there has been a constant and continuous decline in the membership of the church; that the membership of the church in 1928 was 544; that the cause of the shrinkage in membership was caused by the members moving out of Washburn to other localities (R. 144).

Rev. Christiansen testified in the affidavit introduced by the appellants that he is the pastor of the only Norwegian Evangelical Lutheran church in the city of Washburn, and that he has been in charge of the congregation for 22 years; that in the last six or seven years there has been a very substantial shrinkage in the number of members of his congregation; that from the best information available it appears there were 435 members in said congregation in 1914, and that at the present time the membership numbers 245; that said decrease in membership is due to shrinkage in the population of the city and is substantially in proportion to such shrinkage (R. 145).

V. E. Kimball, testified in the affidavit introduced by the appellants that he is the city superintendent of the public schools in the city of Washburn, and has been such for several years last past; that there are four public

schools in the city, and that there are no private or parochial schools teaching general subjects of education in the city; that the school census reports for the year 1924 show that there were 1,252 children of school age in the city, but that he believes the report to be incorrect, and that in his opinion in 1924 there were more children of school age than said census shows; that the 1927 census shows 1,033 children of school age in the city; that the census report for the year 1928 shows 986 children of school age in the city; that he believes there has been a constant and rapid reduction in the number of children of school age in the city of Washburn since the years 1922 and 1923 (R. 149-150).

W. A. Robinson testified in the affidavit introduced by the appellants that he has been a resident of the city of Washburn continuously for more than thirty-five years; that he is the editor and publisher of a weekly paper which has been circulated in Washburn for thirty-five years; that he is familiar with the affairs of the city and has personal acquaintance with practically every resident of the city; that some time in the year 1928 for the purpose of ascertaining whether the circulation of his paper was as great as it should be, he carefully estimated and checked over the population of the city and came to the conclusion that the population was about 2,700, and that the population has been shrinking regularly and continuously for the past six years or more, and that such shrinkage still continues (R. 148-149).

It thus conclusively appears that the population of the city in 1928 was approximately 2200 less than in 1905, and approximately 1000 less than in 1920. This shrinkage of population proves beyond all cavil that the city of Washburn is in a retrogressive condition. Such a condition inevitably affects property values in the city.

The shrinkage of population is reflected to some extent in the record of consumers of the utility. The records of the company show that in 1924 there were 588 customers, in 1925, 558 customers, in 1926, 585 customers, in 1927, 525 customers, and in 1928, 537 customers. It is true that, according to the records of the company, there were more customers in 1928 than in 1927. It will be noted, however, that the number of customers has decreased sharply since 1926, and that such decrease will continue.

C. Scarcity of industries in the city.

Undoubtedly the economic condition of the city of Washburn is caused in part, at least, by a scarcity of industries in the city. It appears that the industries are limited to an excelsior factory which employs about twenty-five people, and a coal dock employing about fifteen men (R. 148). In addition, the Du Pont Powder plant, located in the town of Barksdale, employs about three hundred men, two hundred of whom live in the city of Washburn (R. 148). The industries enumerated constitute practically the only source of income for the city (R. 148-149).

It is a matter of common knowledge that no city with a population of 2700 can hope to progress with the industries we have enumerated. The industrial situation has played an important part in the decline of property values in the city.

D. Plant of the Washburn Water Works Company is larger than is presently required.

There can be no question but that the distribution system of the utility is larger than is required at the present time. To illustrate the present over-development, the appellants introduced a map and a number of photographs

showing the location of various hydrants in the city of Washburn (R. 120-121). Neither the map nor the photographs were printed in the transcript, but are now before the court for inspection (R. 157-159). The photographs were taken during the month of February, 1928, and the points photographed have been indicated on the map (R. 120-121).

We shall not comment on the individual photographs. Suffice it to say that they show various extensions of the distribution system into localities in the city where no customers now live. We do not contend that the construction of the plant was wasteful, extravagant or imprudent. Undoubtedly when these extensions were made the utility had good reason to believe that the city of Washburn would progress in the same manner as other communities have progressed. Experience has shown, however, that the city of Washburn is not a progressive city, but, on the contrary, has retrogressed greatly in the last few years.

If cost of reproduction new is applied strictly to the property owned by the Washburn Water Works Company, the customers of the utility will be obliged to pay rates based on the value of the entire plant, part of which is composed of a distribution system not presently used or useful. Such is not the rule.

> *San Diego Land & Town Co. v. Jasper,* 189 U. S. 439, 446, 447.

We confess that no exhaustive study was made either by the Commission or by counsel representing the appellants to show the extent of the over-development of the utility property.

The evidence does, however, disclose that the present plant was adequate to take care of the increased population during the war; that it was sufficient to take care of a

population of 3,707 in 1920 (R. 139); and that the present population of 2700 (R. 148) must support the utility.

E. Evidence as to conditions in the city of Washburn undisputed.

We suggest that the court in passing upon the question as to whether the Commission accorded proper weight to cost of reproduction new, and in passing upon the question as to whether the order of the Commission is supported by the evidence, should not lose sight of the fact that the evidence respecting the conditions prevailing in the city of Washburn is undisputed. The utility made no effort to contradict the evidence introduced by the appellants; in fact counsel for the utility offered in evidence the affidavit of the receiver containing the true value of the property in Washburn from 1914 to 1928, inclusive (R. 152), which shows that property values in the city in 1928 were substantially the same as they were in 1914 and 1915.

If the court is of the opinion that evidence of the economic conditions in Washburn is relevant in a rate proceeding, we do not believe the order of the commission fixing a value of $75,000 is open to attack.

3. *Rights of the public should be considered.*

The order of the Railroad Commission recites that the rates fixed for the Washburn Water Works Company property by its order of October, 1922, are among the highest in the state (R. 39). If the utility's request for an increase of rates sufficient to produce a return of 8% on a value of $122,952.00 is granted, the rates in Washburn will be the highest in the state. The result of such an increase in rates will directly burden greatly each of the 537 customers which the utility now has. If the population continues to

diminish and the number of consumers becomes smaller, the burden of paying rates sufficient to produce a return of 8% on the value contended for by the utility will be destructive of private property in the city.

It seems to be well settled that a utility is not entitled to a rate base which will be destructive of property in the municipality.

In *Covington, etc. Turnpike Road Co. v. Sandford,* 164 U. S. 578, the court said, page 596:

> "* * * It cannot be said that a corporation is entitled, as of right, and without reference to the interests of the public, to realize a given per cent upon its capital stock. When the question arises whether the legislature has exceeded its constitutional power in prescribing rates to be charged by a corporation controlling a public highway, stockholders are not the only persons whose rights or interests are to be considered. The rights of the public are not to be ignored. It is alleged here that the rates prescribed are unreasonable and unjust to the company and its stockholders. But that involves an inquiry as to what is reasonable and just for the public. * * * The public cannot properly be subjected to unreasonable rates in order simply that stockholders may earn dividends. * * *."

In *San Diego Land and Town Co. v. Jasper,* 189 U. S. 439, the court, in considering the reasonableness of water rates, said, pages 446-447:

> "* * * If a plant is built, as probably this was, for a larger area than it finds itself able to supply, or, apart from that, if it does not, as yet, have the customers contemplated, neither justice nor the Constitution requires that, say, two-thirds of the contemplated number should pay a full return. * * *
>
> "* * * The statute of California no doubt was contemplating the case of waterworks fully occupied within the area which they intended to supply. It hardly

> can have meant that a system constructed for six thousand acres should have a full return upon its value from five hundred, if those were all that it supplied. At all events we will not be the first to say so. * * *."

In the dissenting opinion of Judge Evans in *Ashland Water Co. v. Railroad Comm.*, 7 F. (2d) 924, it was said, page 943:

> "And if these results be not sufficiently startling in their nature, let the possibility of future depopulation of Ashland be considered. If the depopulation which has been going on for 30 years increase—if one-half of the present population should leave—the rates would be enormously increased. And if the rule be an unvarying one, we can continue the speculation until a condition would exist where the utility actually drove the citizens from the city."

We submit that, in the case at bar, the rights of the citizens of Washburn should be considered in determining the value to be used for rate-making purposes. At the present rate of depopulation, the burden of paying water rates will become more and more onerous. We do not believe that a rule fixing values should be so arbitrarily applied as to confiscate property in the city nor do we believe that the utility is constitutionally entitled to a value which will accomplish such result.

IV. Rates fixed by order of the Commission not confiscatory.

In the order of December 4, 1928, the Railroad Commission provided rates which would, in the judgment of the commission, provide for a return of 7 per cent upon a value of $75,000 (R. 52). The lower court was of the opinion that the value of $75,000 placed on the utility property by the Commission was not supported by the evidence (R. 92), and it was therefore not necessary for

it to pass upon the question as to whether the return provided by the order was unreasonable.

The utility contends that the rates fixed by the order are confiscatory, even though it be assumed that the rate base of $75,000 is proper. The Commission estimated that the 1928 operating expenses of the utility, exclusive of depreciation expense, taxes, interest and return would amount to $8,188. The actual operating expenses of the utility for 1928 according to the evidence introduced by the utility amounted to $11,003 (R. 108), and according to the audit made by the commission, amounted to $11,143.30 (R. 119), both figures excluding depreciation, taxes and return.

The Commission in estimating operating expenses rejected actual pumping costs on the ground such costs are excessive, and that such costs may be materially reduced through the installation of a smaller electrical pump (R. 49). The Commission was likewise of the opinion that operating costs could be reduced through the installation of meters (R. 51). The Commission also rejected the item of legal expenses for the purpose of estimating future operating expenses (R. 51). We shall therefore inquire as to whether the Commission exceeded its jurisdiction in disregarding the foregoing items and, if not, whether a return of 7 per cent is confiscatory.

1. *Order makes proper provision for operating expenses.*

In approaching the question as to whether the Commission made proper allowance for operating expenses, we are not unmindful of the rule that an administrative body such as the Railroad Commission is not the financial

manager of the Washburn Water Company. The principle is firmly established that

> "The commission is not the financial manager of the corporation, and it has no power to substitute its judgment for that of the directors of the corporation; nor can it ignore items charged by the utility as operating expenses unless there is an abuse of discretion in that regard by the corporate officers."
>
> *State Public Utilities Commission v. Springfield Gas & E. Co.*, 291 Ill. 209, 234;
> *Missouri ex rel. Southwestern Bell T. Co. v. Public Service Comm.*, 262 U. S. 274, 289.

The rule is sometimes stated to be:

> "Neither the defendants (Public Service Commission) nor the court is charged with the management of the plant; neither may, in the absence of a showing of mismanagement, inefficiency or bad faith, substitute its judgment for that of the plaintiff's officers."
>
> *Brooklyn Borough Gas Co. v. Prendergast*, 16 F. (2d) 615.

The appellants contend that the Commission has not impinged upon the rights of the utility by a violation of the principles thus established, and take the position squarely that the utility, by reason of the retrogressive condition of the city of Washburn, is charged with maintaining a higher degree of operating efficiency than would be required were the plant located in a normal community.

A. Pumping costs for year 1928 were excessive.

In the order of December 4, 1928 the Commission said (R. 49):

> "We are of the opinion, from our investigation of

the operating conditions at Washburn, that a considerable additional saving in the cost of pumping could be brought about by the installation of an additional pump and smaller motor. With the 125 H.P. motor now in use, driving the 1,000 gallon per minute pump, the demand upon the power company has resulted in a rate for energy of about four cents per kilowatt hours. The installation of a smaller pump and motor would decrease the demand and increase the period of pumping correspondingly."

The schedule of rates charged by the Lake Superior District Power Company, from whom the utility purchases electrical current for pumping purposes (R. 125) shows that if the demand is reduced, power can be purchased at a lower rate. Mr. Thiessen, the Commission's engineer, in his affidavit (R. 143) said:

"At present the equipment consists of a motor driven centrifugal pump of a 1,000 gallon per minute rated capacity pumping three or four hours per day to a reservoir upon the hillside above the city. With the 125 H.P. motor driving this pump and the short period of operation, the demand upon the lines of the Lake Superior District Power Company has resulted in a rate for power of about four cents per kilowatt hour."

It will be noted that the rate paid by the Washburn Water Works Company is extremely high. When we consider the small number of customers served, it as apparent that high power costs will result in greatly increased rates for service. We contend that a duty rests upon the Washburn Water Works Company to exert every effort to minimize operating expenses. Mr. Thiessen is of the opinion that the installation of a smaller pump would result in a saving of $2,000 per year, and the evidence sustains this conclusion (R. 141-143). Where the actual op-

erating expenses, as in this case, amount to approximately $11,000 per year, the utility is guilty of a gross abuse of discretion in refusing to effect a saving of $2,000 per year. Such a saving would decrease the operating expenses approximately 18 per cent.

We submit that the action of the Commission in rejecting actual pumping costs should be viewed in the light of the situation in Washburn. Failure on the part of the company to economize to the extent of saving $2,000 per year, where the plant serves only 537 customers, results in an approximate average increase in rates of $3.70 per year per customer. Unless the utility adheres to a rigid program of economy, it will drive all of the inhabitants out of the city of Washburn.

B. Installation of meters will result in decreased operating costs.

The Commission, in commenting on the failure of the utility to install meters said (R. 51):

> "This Commission in previous decisions called attention to the need of installing meters upon at least the larger customers. A considerable part of the excessive pumpage year after year can be attributed to no other cause than the lack of restraint on customers as regards the waste of water. By January 1, 1923, only 51 meters were in use. During 1925, 21 additional were installed, while in 1926, 40 more were placed. During 1927, 44 meters were set, making a total of 156 metered and 369 unmetered customers on December 31, 1927. We believe the decrease in pumpage noted above is due largely to the installation of meters."

Data from the annual reports of the Washburn Water Works Company show that there were 150 meters in place in 1927, 172 in 1928 (R. 140), and the records of the com-

pany show that from January 10, 1929 to March 11, 1929, 50 additional meters were installed (R. 127).

W. G. Maxcy, the receiver, testified in his affidavit that it was not economical to install meters, and that the company had no funds with which to purchase and install the meters. The evidence, however, shows that a deposit was obtained from all the customers who obtained meters in 1929 (R. 127).

The evidence demonstrates conclusively that a considerable saving in pumping costs can be effected by the installation of meters. In 1928 the company had 14.66 per cent more meters installed than during the year 1927 (R. 140). The pumpage in gallons for the year 1927 was 68,550,000, while the pumpage in 1928 was 59,340,000 gallons, or a decrease of 13.4 per cent. While it does not necessarily follow that the decrease is due entirely to the installation of meters, it is significant that the percentage of increase in meters corresponds very closely to the percentage of decrease in pumpage. It is also significant to note that in 1927 power costs for pumping purposes amounted to $5-020.08, and in 1928 these costs were reduced to $4,581.05 (R. 108), a decrease of approximately ten per cent.

On March 11, 1929, the company had in place approximately 30 per cent more meters than in the year 1928. Assuming that no more meters were installed during the year 1929 and that the same ratio of decrease in cost of power purchased for pumping purposes would obtain during the year 1929 as for the year 1928 (14 per cent increase in meters resulting in 10 per cent decrease in cost of power for pumping purposes) the cost of power for pumping purposes during the year 1929 would be approximately 20 per cent less than that for the year 1928, or approximately the sum of $3665. The decrease in pumping costs represents a clear saving. The operating expenses for the year

1928, exclusive of pumping costs, are no higher than the operating expenses for 1927 (R. 108).

Mr. Hartt, the utility's engineer, testified in his affidavit (R. 112) that the difference in pumpage between the years 1926 and 1927 was due to the installation of the electric pump; that the pumpage of the steam pump was computed by counting the strokes, and that by reason of slippage in the steam pump the pumpage as computed by counting the strokes was inaccurate. We do not quarrel with this explanation. There is, however, no explanation by the utility for a decrease in pumping of approximately 9,200,000 gallons in 1928.

In view of the evidence in the case at bar, we believe the finding of the Commission that operating costs could be reduced through the installation of meters should not be disturbed.

C. Legal expenses should not be considered as normal operating expense.

The Railroad Commission, in estimating the operating expenses of the utility, disregarded the item of legal expenses. In this connection, the Railroad Commission said (R. 51):

> "* * * Further, during the last five years particularly, considerable sums have been charged to operation covering disbursements incurred fighting this Commission's orders. Totals of these items will not be considered in determining the normal cost of operating the Washburn property."

The language used by the Commission is significant. It will be noted that the Commission specifically points out that the item of legal expense would not be considered in determining the *normal* cost of operating the utility.

The Commission did not exceed its jurisdiction in so holding. It is reasonable to suppose that the present litigation will eliminate any further necessity for legal expense, particularly in connection with rate proceedings.

There is a line of authorities holding that legal expenses should not be included in the operating expenses for the purpose of arriving at a rate which will yield a fair return on the fair value of the property.

Spring Valley Water Works v. City, etc. of San Francisco, 192 Fed. 137, 190;
San Diego Water Co. v. City of San Diego, 118 Cal. 556, 574, 50 Pac. 633;
City of Winona v. Wisconsin-Minnesota L. & P. Co., 276 Fed. 996, 1005.

In *Monroe Gaslight & Fuel Co. v. Michigan Public Utilities Comm.,* 11 F. (2d) 319, 325, it was held that legal expenses may properly be considered as a part of the operating expenses for rate making purposes. However, in *Columbus Gas & Fuel Co. v. City of Columbus,* 17 F. (2d) 630, 640, the court said:

> "The Court is able to find no decision, however, where the Court has held directly that the legal expense of the utility, arising in preparation and prosecution of its claim of unconstitutionality, is allowable, to directly produce or influence that unconstitutionality. Such would appeal to the Court to be unreasonable as well as inequitable."

The utility is attempting to do that which the Court in the foregoing decision held could not be done; it is attempting to base the confiscatory character of the rate established upon the proposition that the Railroad Commission made no allowance for legal expense. We submit that such a claim is unreasonable and inequitable.

2. *Past losses need not be considered in fixing rates.*

The utility seems to base its right to receive an increase in rates upon the proposition that it has suffered losses in the past. The bill of complaint alleges (R. 23):

> "This annual confiscation has continued for several years in the past and is largely responsible for the present plight of the plaintiff company and relief should and must be granted, as set forth in this complaint."

The utility's contention is out of line with the decisions of this court. It is well settled that

> "Past losses cannot be used to enhance the value of the property or to support the claim that rates for the future are confiscatory."
>
> *Board of Public Utility Commrs. v. New York Telephone Co.*, 271 U. S. 23, 31;
> *Galveston Electric Co. v. Galveston*, 258 U. S. 388, 395;
> *Georgia Ry. & P. Co. v. Railroad Comm.*, 262 U. S. 625, 632.

3. *Return of 7% on value of $75,000 not confiscatory*

The order of the Commission of December 4, 1928 provides for a return of 7% on a value of $75,000.00 (R. 52). A return of 7% for the Washburn Water Works Company, situated as it is, is not confiscatory.

In *Cedar Rapids Gaslight Co. v. Cedar Rapids*, 223 U. S. 655, 670, the court declined to reverse the state court which upheld a rate of return exceeding 6%.

A rate of return of 6% was sustained in *Stanislaus*

County v. San Joaquin and K. River etc. Co., 192 U. S. 201; *Knoxville v. Knoxville Water Co.*, 212 U. S. 1; *Des Moines Gas Co. v. Des Moines*, 238 U. S. 153. See also *Dayton-Goose Creek R. Co. v. United States*, 263 U. S. 456, 486.

In *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 420, it was held that a return of 7% was not confiscatory.

The question as to whether a return in a given case is unreasonable depends upon all the facts and circumstances in the case.

In *Bluefield Water Works and Imp. Co. v. Public Service Commission*, 262 U. S. 679, the court pointed out that, in *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, it was held, pages 48-50:

> "That the question whether a rate yields such a return as not to be confiscatory depends upon circumstances, locality and risk, and that no proper rate can be established for all cases; and that, under the circumstances of that case, 6 per cent was a fair return on the value of the property employed in supplying gas to the City of New York, and that a rate yielding that return was not confiscatory. In that case the investment was held to be safe, returns certain and risk reduced almost to a minimum—as nearly a safe and secure investment as could be imagined in regard to any private manufacturing enterprise."

In view of the economic conditions prevailing in the city of Washburn, it is safe to say that no industry in the city could possibly make a return of 7% on the fair value of its property. In these circumstances, is the Washburn Water Works Company entitled to a 7% return? The answer to this question is in the negative. The Washburn Water Works Company should be compelled to share in the general depression, and receive a return commensurate with the return of similar business enterprises located in the city. We suggest to the court that the Railroad Com-

mission in this case would have been fully justified in fixing a rate of return at a much lower figure than 7%. The utility, therefore, is in no position to urge that a return of 7% is confiscatory.

Again, in determining whether the return established by the order is confiscatory, we must not lose sight of the fundamental principle that the burden rests on the utility to prove that the rate of return is confiscatory.

> *Knoxville v. Knoxville Water Co.*, 212 U. S. 1;
> *United Fuel Gas Co. v. Railroad Comm.*, 73 L. ed. 390, 398.

It is also fundamental that the findings of an administrative board or tribunal are conclusive where supported by the evidence. In *United States v. Erie R. Co.*, (Adv. Opinions), 74 L. ed. 74, the court, in speaking of an order of the Interstate Commerce Commission, said, pages 75-76:

> "* * * The findings of the Commission [Interstate Commerce Commission], that the broker acts only as agent and that from the time that the pulp is put aboard the steamer there is a continuing intent that it should be transported to Garfield, ought to have been accepted by the District Court as conclusive, since there was ample evidence to sustain it."

An order of an administrative body is presumptively correct.

> *Wisconsin-Minnesota L. & P. Co. v. R. R. Comm.*, 267 Fed. 711, 718;
> *United Fuel Gas Co. v. R. R. Comm.*, 73 L. ed. 390, 398;
> *Cambridge Electric Light Co. v. Atwill*, 25 F. (2d) 485, 487.

In *Knoxville v. Knoxville Water Company,* 212 U. S. 1, the court said, page 8:

> "The constitutional invalidity should be manifest, and where that invalidity rests upon disputed questions of fact the invalidating facts must be proved to the satisfaction of the court. In view of the character of the judicial power invoked in such cases it is not tolerable that its exercise should rest securely upon the findings of a master, even though they be confirmed by the trial court. The power is best safeguarded against abuse by preserving to this court complete freedom in dealing with the facts of each case. Nothing less than this is demanded by the respect due from the judicial to the legislative authority."

The order of the Commission in the case at bar, we submit, is supported by the evidence. The Commission has exercised its discretion honestly and fairly, and has attempted to fix a rate which will yield to the utility a fair return upon the fair value of its property in the city of Washburn. Under the record in this case, we do not believe it has been made to appear that the order of the Commission is unreasonable, unlawful or confiscatory.

We respectfully submit that the decree of the lower court should be reversed.

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